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QWEST COMMUNICATIONS INTERNATIONAL, INC.

Report of Independent Accountants on Applying Agreed-Upon Procedures
June 5, 2006

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June 9, 2006

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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Office of the Secretary
9300 East Hampton Drive
Capitol Heights, Maryland 20743

Section 272 Biennial Report for Qwest Communications International, Inc.
EB Docket No. 03-198

Dear Ms. Dortch:

Pursuant to Section 31(e) of the "General Standard Procedures for Biennial Audits Under Section 272 of the Communications Act of 1934, as amended" in the above referenced matter, Ernst & Young is filing our Report of Independent Accountants on Applying Agreed-Upon Procedures with the following appendices:

- Appendix A – Results of Agreed-Upon-Procedures
- Appendix B – General Standard Procedures for Biennial Audits Required Under Section 272 of the Communications Act of 1934, As Amended, Final Procedures, June 1, 2006
- Appendix C – Comments from Qwest Communications International, Inc.

This document will also be filed electronically through the Federal Communication Commission's Electronic Comment Filing System.

Sincerely,

Deena Clausen

Deena Clausen
Executive Director

cc: Arizona Corporation Commission
Colorado Public Utilities Commission
Idaho Public Utilities Commission
Iowa Utilities Board
Minnesota Public Utilities Commission
Montana Public Service Commission
Nebraska Public Service Commission
New Mexico Public Regulation Commission
North Dakota Public Regulation Commission
Oregon Public Utility Commission
South Dakota Public Utilities Commission
Utah Public Service Commission
Washington Utilities & Transportation Commission
Wyoming Public Service Commission
Qwest Communications International, Inc.



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# Report of Independent Accountants on Applying Agreed-Upon Procedures

To the Management of Qwest Communications International, Inc.
and the Joint Federal/State Oversight Team

We have performed the procedures enumerated in Appendix B, which were agreed to by management of Qwest Communications International, Inc. (QCII) and the Joint Federal/State Oversight Team (Joint Oversight Team)[1] (collectively, the "Specified Parties"), solely to assist these specified parties in evaluating QCII's compliance with the requirements of Section 272 of the Communications Act of 1934, as amended (Section 272 Requirements),[2] during the period from January 2, 2004 to January 1, 2006 (the Engagement Period). QCII's management is responsible for compliance with the Section 272 Requirements. This engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the Specified Parties of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Appendix B either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and the results obtained are documented in Appendix A. These procedures and the results are not intended to be a legal interpretation of the regulatory rules, regulations or requirements.

We were not engaged to, and did not, conduct an examination, the objective of which would be the expression of an opinion on QCII's compliance with the Section 272 Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management of QCII and the Joint Oversight Team, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Ernst + Young LLP

June 9, 2006

[1] The "Joint Oversight Team" is composed of staff members from 14 state regulatory agencies and the Federal Communications Commission ("FCC"). Qwest Corporation operates in the following 14 states: Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming.

[2] These requirements are contained in 47 U.S.C. Section 272(b), (c) and (e) of the Communications Act of 1934, as amended (the "Act"), and in 47 C.F.R. Section 53.209(b) of the Federal Communications Commission's rules and regulations.

## APPENDIX A

### Results of Agreed-Upon Procedures

**<u>OBJECTIVE I</u>. Determine whether the separate affiliate[1] required under section 272 of the Act has operated independently of the BOC.[2]**

1. Inquired of Management[3] whether there have been any changes in the certificate of incorporation, bylaws, and articles of incorporation of Qwest Communications Corporation (QCC) and Qwest LD Corp. (QLDC), (collectively "the Section 272 Affiliates")[4] during the Engagement Period[5], and whether there have been any legal and/or "doing business as" (DBA) name changes during the Engagement Period. Management represented that there were no changes in the certificate of incorporation, bylaws, and/or articles of incorporation of the Section 272 Affiliates during the Engagement Period. Management also represented that there were no name changes (DBA or legal) to QCC and QLDC during the Engagement Period. Management represented that no Section 272 Affiliates were established or formed during the Engagement Period.

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[1]"Affiliate" is defined in Paragraph 13 of the General Standard Procedures (Appendix B) as a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For this purpose, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent. (See Section 3 of the Communications Act of 1934, as amended (the "Act").)

[2]"BOC" is defined in Paragraph 11 of the General Standard Procedures as Bell Operating Company. If the BOC transfers or assigns to an affiliated entity ownership of any network elements that must be provided on an unbundled basis pursuant to Section 251(c)(3), such entity shall be subject to all of the requirements of the BOC. For purposes of this engagement, in the event that the BOC provides exchange and/or exchange access services on a retail or wholesale basis exclusively through one or more of its subsidiaries or affiliates, or through one or more other subsidiaries, divisions, etc., of the parent Regional Holding Company, and the same services cannot be purchased directly from the BOC, then these entities shall also be subject to all of the relevant nondiscriminatory requirements of Objectives VII through XI of this document. Affiliates that merely resell the BOC's exchange services and/or exchange access services or lease unbundled elements from the BOC, or engage in permissible joint marketing activities (see Section 272(g)(1) of the Act), shall be excluded from these requirements.

[3]"Management" refers to refers to officers, directors, managers or other employees of QCII, Qwest Services Corporation (QSC) or other administrative services affiliates reporting directly to QCII or QSC who have management responsibility for Qwest Corporation and the Section 272 Affiliates.

[4]"Section 272 Affiliate" is defined in Paragraph 14 of the General Standard Procedures (Appendix B) as including the following companies: Qwest LD Corp., Qwest Communications Corporation and any other affiliate of Qwest Communications International, Inc. ("QCII") that originates interLATA telecommunications services in the QCII region that is subject to Section 272 separation requirements, and any affiliate that engages in manufacturing activities as defined in Section 273(h). Paragraph 14 also states that the audit procedures are required to be performed, unless otherwise specified, on all Section 272 Affiliates as defined by the Act.

[5] The "Engagement Period" is defined in Paragraph 7 of the General Standard Procedures (Appendix B) as the period January 2, 2004 to January 1, 2006.

2. Obtained[6] and inspected the corporate entities' organizational charts of the Qwest BOC[7], Section 272 Affiliates and QCII as of January 1, 2006. Obtained written confirmations from legal representatives of the Qwest BOC, Section 272 Affiliates and QCII that confirmed the legal, reporting and operational corporate structure of the Section 272 Affiliates. Noted that the organizational charts and written confirmations obtained from legal representatives of the Section 272 Affiliates stated that QCC and QLDC are wholly owned subsidiaries of Qwest Services Corporation (QSC). Noted that the organizational charts and written confirmations obtained from legal representatives of the Qwest BOC stated that the Qwest BOC is a wholly owned subsidiary of QSC, QSC is a wholly owned subsidiary of QCII and QCII is the parent of all Qwest companies. QCII is a publicly traded entity.

3. Inquired of Management, and obtained the following representations from Management related to operating, installation and maintenance functions (OI&M) performed on facilities owned by the Section 272 Affiliates or leased from a third party by the Section 272 Affiliates for the period from January 2, 2004 to March 30, 2004:

   a. Obtained Management's definition and interpretation of OI&M functions. Qwest's management defines OI&M based on the guidance contained in paragraph 158 of the Non-Accounting Safeguards Order[8] and relies on the common meaning of the words in paragraph 158. Qwest uses the definition of OI&M to generally include all activity related to installing, operating, and maintaining (e.g., making repairs to) switching and transmission facilities subject to section 53.203(a)(1).[9]

   b. Management represented that neither the Qwest BOC nor any other affiliated entities performed the above-described OI&M services on facilities either owned by QCC or leased from a third party by QCC prior to March 30, 2004.

---

[6] For purposes of this engagement, the term "obtain" is defined in Paragraph 16 of the General Standard Procedures (Appendix B) and "obtained" as used in Appendix A, shall mean that E&Y physically acquired, and generally retained in the working papers, all documents supporting the work effort performed to adequately satisfy the requirements of a procedure. E&Y used professional judgment to decide which items were too voluminous to include in the working papers. E&Y included a narrative description of the size of such items, as well as any other reasons for their decision not to include them in the working papers.

[7] "Qwest BOC," as defined in Paragraph 12 of the General Standard Procedures (Appendix B) includes Qwest Corporation and any successor or assign of such company as described in footnote 2 above. The term "ILEC" ("Incumbent Local Exchange Carrier") includes Qwest Corporation and any successor or assign of such company as described in footnote 2 above.

[8] The "Non-Accounting Safeguards Order" refers to *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report And Order And Further Notice Of Proposed Rulemaking, released December 24, 1996.

[9] See *Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149, Memorandum Opinion and Order, FCC 03-271, n.13 (2003).

Management represented that QLDC did not own or operate transport or switching facilities and operated as a reseller, therefore, did not require any OI&M activities prior to March 30, 2004.

c. Management represented that neither QCC nor QLDC performed the above-described OI&M services on facilities either owned by the Qwest BOC or leased from a third party by the Qwest BOC prior to March 30, 2004.

4. For the period March 31, 2004 to January 1, 2006, inquired and documented the following representations from Management:

a. Management represented that from March 30, 2004 to January 1, 2006, the Qwest BOC performed the following OI&M services on facilities owned by QCC or leased by QCC:

- Engineering, Planning and Technical Support service provided as of and after June 7, 2004
- Cable Locate service provided as of and after July 18, 2004
- Joint Marketing Support (CPE requirements and service qualification) provided as of and after August 11, 2004
- Public Safety Answering Point and Communications Assistance for Law Enforcement Act Services provided as of and after January 15, 2005
- Call Handling – Repair and call transfer provided as of and after October 18, 2004
- Qwest Technical Installation Service provided as of and after January 12, 2005
- Program Management Support for E-911 provided as of and after July 1, 2005

Noted that the services listed above were included in the Call Handling Work Order and the Consulting and Support Work Order agreements between QCC and the Qwest BOC that were posted on the Qwest public website.

Management also represented that only one service, QSC Network Planning and Technical Support, provided as of and after June 7, 2004, was provided by other non-Section 272 Affiliates after March 30, 2004.

b. Management represented that the only OI&M service performed after March 30, 2004, by any Section 272 Affiliate on facilities either owned by the Qwest BOC or leased from a third party by the Qwest BOC was strike preparation services. Management stated that QCC employees were trained to perform work for the Qwest BOC in the event of a strike by the Qwest BOC's labor union members upon their agreement expiration on August 13, 2005. Management further represented that the strike did not occur and, other than the preparatory training, no other OI&M work was performed by QCC for the Qwest BOC.

5. Management represented that the Qwest BOC did not provide research and development activities or services to the Section 272 Affiliates or non-affiliated entities during the Audit Test Period.[10]

6. Obtained the balance sheets of QCC and QLDC as of the end of the Audit Test Period, September 30, 2005. Noted that QLDC owned no fixed assets as of September 30, 2005. Management represented, effective December 31, 2003, capital assets are no longer being purchased by Qwest N. Limited Partnership (QNLP) and being leased to QCC, therefore no operating leases were set up during the Engagement Period between QCC and QNLP. Obtained a listing of all fixed assets including capitalized software, capitalized leases and a listing of all fixed assets covered in the pre-2004 operating leases between QCC and QNLP, (collectively "fixed asset listings"). Noted that the initial asset listings provided did not contain all of the requested detail as defined in b and c, however, all requested detail was provided for the sampled assets as noted in b and c below.

   a. Noted that Property, Plant and Equipment and Intangibles (PP&E) listed on QCC consolidated balance sheet (including QNLP) as of September 30, 2005, totaled \$1,825,146,410. The balance of the fixed assets listings obtained as of September 30, 2005, was \$1,647,630,958, resulting in a difference of \$177,515,733. Reconciled this amount based on data provided by Qwest to the total of the fixed asset listings. The reconciling differences are as follows:

**Table 1:**
**Summary of Reconciling Differences Between Fixed Asset Listings Tested and the PP&E Balance per the QCC Consolidated Balance Sheet (including QNLP) as of September 30, 2005**

| Line Item | Reconciling Difference | Explanation |
|---|---|---|
| 1 | $48,156,554 | Items recorded on the general ledger (balance sheet) but not yet posted to the detailed asset listings – primarily consisting of accruals related to pending litigation and estimated cost of asbestos removal. |

[10] The "Audit Test Period" is defined in Paragraph 7 of the General Standard Procedures (Appendix B) as January 2, 2004 to September 30, 2005.

| Line Item | Reconciling Difference | Explanation |
|---|---|---|
| 2 | $(6,188,674) | Consisted of 1) QNLP support assets (i.e., assets not leased to QCC) of approximately $5 million that were not provided in the initial asset listing and 2) the sale of approximately $11 million in QNLP assets between July 1, 2005 and September 1, 2005. Noted that Qwest subsequently provided a detailed listing of the $5 million in support assets upon inquiry. |
| 3 | $(1,155,191) | July 2005 activity with placed-in-service dates prior to 2000. |
| | | |
| 4 | $4,083,074 | Materials and Supplies – included in PP&E on September 30, 2005 balance sheet. |
| 5 | $65,383,697 | Support Assets – included in PP&E on September 30, 2005 balance sheet. |
| 6 | $9,253,280 | Held for Future Use Assets – included in PP&E on September 30, 2005 balance sheet. |
| 7 | $57,982,993 | Under Construction Assets – included in PP&E on September 30, 2005 balance sheet. |
| **8** | **$177,515,733** | **Total Difference** |

b. From the fixed asset listings as of June 30, 2005, obtained in procedure a. above, including listings for fixed assets, capitalized software and operating leases, identified 2,338 capital items acquired by QCC from January 2, 2004 to June 30, 2005. Randomly selected a sample of 67 assets and noted that the fixed asset listing did not contain all of the requested detail as defined in b and c, however, all requested detail was provided for the 67 sampled assets.

   From the 2,338 capital assets acquired from January 2, 2004 to June 30, 2005, identified 1,173 transmission and switching assets. Randomly selected 61 transmission and switching assets acquired from January 2, 2004 to June 30, 2005, and inspected documentation supporting QCC ownership (invoices, journal entries, purchase orders, labor activity reports, internal transfer records and internal payroll records) for each asset. Differences noted are discussed in procedure c. below.

c. From the fixed asset listings for the period July 1, 2005 to September 30, 2005, obtained in procedure a. above, including detailed listings for fixed assets, capitalized software and operating leases, identified 1,174 capital items acquired by QCC from July 1, 2005 to September 30, 2005. Randomly selected a sample of 33 assets and noted that the detailed fixed asset listing did not contain all of the requested detail as defined in b and c, however, all requested detail was provided for the 33 sampled assets.

From the 1,174 capital assets acquired from July 1, 2005 to September 30, 2005, identified 758 transmission and switching assets. Randomly selected 39 transmission and switching assets acquired from July 1, 2005 to September 30, 2005, and inspected documentation supporting QCC ownership (invoices, journal entries, purchase orders, labor activity reports, internal transfer records and internal payroll records) for each asset. Differences noted for the sample of 100 transmission and switching assets acquired during the Audit Test Period (61 assets tested in procedure b. above and 39 assets tested in procedure c.) are listed below.

- For two of the 100 assets tested, QCC could not provide documentation that indicated QCC's ownership of the asset. Management represented that these assets were purchased prior to 2004 (but placed in-service during the Engagement Period) and documentation was not available.
- For two of the 100 assets tested, the address identification numbers on the ownership documentation provided did not match the address identification number of the tested asset.
- For one of the 100 assets tested, noted that labor was incorrectly capitalized and subsequently reversed. The asset item selected for testing was the entry to reverse the capitalization. As this entry was the removal of an asset recorded in error, documentation of ownership was not applicable.
- For 95 of the 100 assets tested, documentation provided substantiated QCC's 100% ownership of the asset. For 16 of the 95 assets, the purchaser listed on the supporting invoices was listed as "Qwest Communications." Management represented that "Qwest Communications" refers to QCC.

d. Except as noted above, all information and documentation required for the execution of Objective I, Procedure 6 was made available by the Section 272 Affiliates.

**<u>OBJECTIVE II</u>. Determine whether the separate affiliate required under section 272 of the Act has maintained books, records and accounts in the manner prescribed by the Commission that are separate from the books, records and accounts maintained by the BOC.**

1. Obtained access to the general ledger of each Section 272 Affiliate as of September 30, 2005. Noted that separate general ledgers for QCC, QLDC and the Qwest BOC are maintained on the PeopleSoft PROFIT (Professional Financial Information Tool) system. Noted that unique enterprise codes are maintained for each legal entity in PROFIT. Reviewed the enterprise codes on Section 272 Affiliates' general ledgers and noted that they are defined as the enterprise codes for the Section 272 Affiliates. Matched the title on the QCC and QLDC general ledger with the names of the Section 272 Affiliates on their certificates of incorporation and determined that a separate general ledger was maintained for each Section 272 Affiliate. No special codes linking the Section 272 Affiliates' general ledgers to the Qwest BOC general ledger were noted. Noted that separate QSC employees enter the journal entries for the 272 affiliates and the Qwest BOC separately into PROFIT.

2. Obtained QCC's balance sheet as of September 30, 2005, and income statement for the nine months ended September 30, 2005. Obtained QLDC's balance sheet as of September 30, 2005, and QLDC's income statement for the nine months ended September 30, 2005.

3. Obtained a listing of lease agreements for each Section 272 Affiliate as of September 30, 2005, that included leases entered into or modified during the Audit Test Period. Identified 17 leases, entered into or modified during the Audit Test Period, for which the annual obligation listed in the lease agreement is $500,000 or more. Noted that the listing obtained included leases for which the Section 272 Affiliate was either lessor or lessee. Obtained the written policies and procedures of the Section 272 Affiliates for complying with the requirement to maintain their books, records and accounts in accordance with GAAP. For 17 leases with annual obligations greater than $500,000, noted the terms and conditions and determined that the 17 leases were accounted for in accordance with generally accepted accounting principles (GAAP) during the Audit Test Period.

4. Management represented that, during the Engagement Period, QCC did not merge with QLDC and QLDC provided in-region toll services primarily to residential and small business customers.

**<u>OBJECTIVE III</u>. Determine whether the separate affiliate required under section 272 of the Act has officers, directors and employees that are separate from those of the BOC.**

1. Inquired and documented that each Section 272 Affiliate and the Qwest BOC maintain separate boards of directors, separate officers, and separate employees. Obtained a list of the names of directors and officers of the Qwest BOC and the Section 272 Affiliates, including the dates of service for each board member and officer who served during the Engagement Period. Confirmed the list of officers and directors by comparing it with board of director meeting minutes, board of director memorandum or personnel records. No differences were noted. Compared the list of directors and officers of the Qwest BOC with the list of the names of directors and officers of each Section 272 Affiliate. Noted that there were no directors or officers who simultaneously served as a director or officer of both Section 272 Affiliate and the Qwest BOC during the Engagement Period.

2. Obtained listings of all employee names, employment dates and employee identification numbers of the Qwest BOC, QCC and QLDC for the Engagement Period. Noted that QSC maintains employee identification numbers for employees of each of these entities. Management represented that the employee identification numbers are unique and linked to the employee's social security number. Management also represented that the employee identification number is used throughout an individual's employment with any QCII affiliate and is reissued to an employee if they are rehired. Ran a query comparing the names and employee identification numbers from each listing. The query produced the names of 208 employees appearing on the employee listings of the Qwest BOC and QCC during the Engagement Period. Noted from the employment dates listed that the 208 employees appearing on both lists terminated employment with one entity before starting employment with the other entity and that no employees appeared on both the Qwest BOC listing and the Section 272 Affiliates listing simultaneously during the Engagement Period.

**<u>OBJECTIVE IV</u>. Determine that the separate affiliate required under section 272 of the Act has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC.**

1. Obtained Management's representation, and documented in the workpapers, regarding modifications to QCC's and QLDC's intercompany debt agreements with Qwest Capital Funding during the Engagement Period. Noted no guarantees of recourse to the Qwest BOC assets, either directly or indirectly through another affiliate. The Section 272 Affiliates represented that they had no credit arrangements with non-affiliated lenders or major suppliers of goods and services during the Engagement Period. QCC also represented that its outstanding public debt agreement was not modified during the Engagement Period.

2. For the 17 QCC and QLDC lease agreements with annual obligations greater than $500,000 obtained in Objective II, Procedure 3, noted that QCC was the lessor for one lease. For the 16 remaining QCC and QLDC leases, reviewed the lease agreements and noted that there were no instances in which a Section 272 Affiliate's lease agreement had recourse to the Qwest BOC assets either directly or indirectly through another affiliate.

3. From the listing of 17 QCC and QLDC lease agreements obtained in Objective II, Procedure 3 that were entered into or modified during the Engagement Period and had annual obligations greater than $500,000, identified four lease agreements with affiliates and one lease where QCC was the lessor. For the remaining 12 leases plus judgmental sample of ten leases with annual obligations less than $500,000 that were entered into or modified during the Audit Test Period and a judgmental sample of ten new leases entered into or modified during the period October 1, 2005 to January 1, 2006 (32 total leases), requested positive written confirmation that the lessors had no recourse, either directly or indirectly, to the assets of the Qwest BOC. The Section 272 Affiliates represented that there are no credit arrangements with vendors or other third parties and no confirmations were sent. Of the 32 confirmations sent; received 17 replies that positively confirmed that the lessor has no recourse, either directly or indirectly, to the assets of the Qwest BOC and one confirmation that stated the lessor has "no recourse to any assets of the Qwest Bell Operating Company other than the $416 security retainer we have per the terms of the sublease agreement."

**<u>OBJECTIVE V</u>. Determine whether the separate affiliate required under section 272 of the Act has conducted all transactions with the BOC on an arm's length basis with the transactions reduced to writing and available for public inspection.**

**<u>OBJECTIVE VI</u>. Determine whether or not the BOC has accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.**

*Note: Objectives V and VI are tested concurrently and share the same standards and procedures.*

1. Obtained from the Qwest BOC descriptions of the internal procedures for processing complaints and potential complaints before the FCC. The Qwest BOC represented that the complaint procedures are divided into the following four activities for both formal and informal complaints:

    - Complaint Intake,
    - Complaint Tracking,
    - Complaint Processing, and
    - Complaint Follow-up.

    Documented, in the workpapers, the procedures used by the Qwest BOC to identify, track, respond and take corrective action concerning competitors' complaints relating to alleged violations of the Section 272 Requirements. Also documented, in the workpapers, a listing of personnel responsible for complaint activities.

    The Qwest BOC represented that none of the following types of complaints, involving alleged noncompliance with the Section 272 Requirements, including complaints submitted by competitors related to the provision or procurement of goods, services, facilities and information, or in connection with the establishment of standards, were filed during the Engagement Period.

    - FCC formal complaints, as defined in 47 CFR 1.720;
    - FCC informal complaints, as defined in 47 CFR 1.716; and
    - Written complaints made to a state regulatory commission from competitors.

    The Qwest BOC also represented that there were no open complaints as of January 4, 2004. Also, the Qwest BOC represented that no complaints were received during the Engagement Period with respect to:

    - Allegations of cross-subsidies (for Objectives V and VI);
    - Allegations of discriminatory provision or procurement of goods, services, facilities, customer network services information (excludes customer proprietary

network information (CPNI)), or the establishment of standards (for Objective VII);

- Allegations of discriminatory processing of orders for, and provisioning of, exchange access and exchange services and unbundled network elements, and discriminatory resolution of network problems (for Objective VIII);
- Allegations of discriminatory availability of exchange access facilities (for Objective IX); and
- Allegations of discriminatory availability of interLATA facilities or services not at the same rates and not on the same terms and conditions as the interLATA affiliate (for Objective XI).

2. Obtained from the Qwest BOC and each Section 272 Affiliate current written procedures for transactions with affiliates and compared these procedures with the following FCC rules and regulations:

    - 47 C.F.R. §§ 32.27, 53.203(e), and 64.901;
    - *Implementation of the Telecommunication Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report and Order, 11 FCC Rcd. 17,539, at ¶¶ 122, 124, 137, 183, and 265 (rel. December 23, 1996) (Accounting Safeguards Order);
    - *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report And Order And Further Notice Of Proposed Rulemaking, at ¶¶ 180, 193, and 218 (rel. December 24, 1996), (Non-Accounting Safeguards Order);
    - *2000 Biennial Regulatory Review–Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, CC Docket Nos. 00-199, 97-212, 80-286, and 99-301, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286 (*Phase II Report and Order*), Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286, FCC 01-305 (rel. November 5, 2001) (*Further Notice of Proposed Rulemaking*), at Appendix F, Section 32.27 *(Phase 2 Order)*; and
    - *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates,* WC Docket No. 03-228, Report and Order, at ¶¶ 8, 12, 16, 24 and 31.

Noted that the Qwest BOC's and the Section 272 Affiliates' written policies and procedures addressed the above FCC rules and regulations with the exception of the following differences noted:

- For transactions involving the sale or transfer of assets or products between the carrier and affiliates, or chained transactions 47 C.F.R. §§ 32.27 defines a floor by stating the following: "When assets are sold by or transferred from a carrier to an affiliate, the higher of fair market value and net book cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive." The definition of a ceiling is: "When assets are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and net book cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive." The Qwest BOC's and Section 272 Affiliates' written procedures state: "The floor and ceiling rules do not apply to transactions with Section 272 Affiliates because the FCC believes this does not meet the definition of 'arm's length.'"

- For transactions involving the provision of services between the carrier and affiliates, or chained transactions the regulations state the definition of a floor as: "When services are sold by or transferred from a carrier to an affiliate, the higher of fair market value and fully distributed cost establishes a floor, below which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or greater than the floor, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive." The definition of a ceiling is: "When services are purchased from or transferred from an affiliate to a carrier, the lower of fair market value and fully distributed cost establishes a ceiling, above which the transaction cannot be recorded. Carriers may record the transaction at an amount equal to or less than the ceiling, so long as that action complies with the Communications Act of 1934, as amended, Commission rules and orders, and is not otherwise anti-competitive." The Qwest BOC's and Section 272 Affiliates' written procedures state: "The floor and ceiling rules do not apply to transactions with Section 272 Affiliates. The FCC noted that section 272(b)(5) of the Communications Act requires arm's length transactions between a BOC and its Section 272 Affiliate. Recording a transaction at the higher or lower of cost or market as a floor or ceiling may not meet the definition of 'arm's length,' and therefore may not be used in transactions where arm's length transactions are required under the Communications Act or otherwise required by Commission rule or order."[11]

3. Inquired and documented how the Qwest BOC and each Section 272 Affiliate disseminate the FCC Rules and Regulations and raise awareness among employees for compliance with the affiliate transaction rules. Obtained an overview of Qwest's compliance organization. Affiliate compliance is part of the overall Corporate Compliance[12] and Regulatory Compliance[13] groups at Qwest. The Qwest Corporate Ethics & Compliance group which is comprised of QSC employees, manages, interprets and receives reports of potential wrongdoing. This group also enforces Qwest's Code of Conduct and Corporate Policies, which provides the foundation for Qwest's standards for employee conduct. Corporate Compliance typically covers employee obligations that arise out of employment itself and apply across multiple business units. The Qwest Regulatory Compliance group, which is comprised of QC and QSC employees, provides compliance advice, information and training to Qwest employees related to federal and state telecommunications regulations. In addition, Qwest has a Regulatory Accounting group and a 272 Compliance Oversight Team. The Regulatory Accounting group, which is comprised of QC and QSC employees, is primarily responsible for compliance with FCC accounting rules. The 272 Compliance Oversight Team is made up of representatives from Regulatory Accounting, Regulatory Finance, and Policy and Law, who continually monitor the Qwest BOC and the Section 272 Affiliates to ensure that the Section 272 rules are being followed.

   Management represented that while regulatory affiliate accounting compliance policy, procedures and reporting are primarily the responsibility of Regulatory Accounting, many organizations across Qwest are involved in and responsible for identifying and booking affiliate transactions. Telecommunications services are ordered via an internal telecommunications group that is knowledgeable on affiliate transactions and Section 272 rules. Wholesale services that are offered to all carriers are provisioned by the Wholesale Market Unit (QC, QSC, and QCC employees) following their standard procedures. Non-telecommunications types of services are mainly tracked and billed by the Affiliate Transactions group in Regulatory Accounting using the Billing and Accounts Receivable Tracking (BART) system. Non-telecommunications services provided between affiliates ranging from finance and legal to network types of services included costs such as labor, systems and overheads. Regulatory Accounting has implemented the processes and is responsible for ensuring that pricing complies with FCC affiliate transactions rules."

   Interviewed nine employees responsible for developing and recording in the books or records of the carrier transactions affected by these rules during the Engagement Period.

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[11] *Phase 2 Order*, Footnote 176.
[12] The Corporate Compliance group is made up of employees of QSC.
[13] The Regulatory Compliance group is made up of employees of QSC and the Qwest BOC.

Noted that these employees were aware of and demonstrated knowledge of the Section 272 Requirements and affiliate transaction rules. Two of the individuals interviewed were employees of the Qwest BOC and seven of the individuals interviewed above were employees of QSC. Noted that all individuals interviewed were supervised within their respective organizations.

Noted the following list of Section 272 compliance training programs and information distributed to employees:

- In 2004, the Corporate Code of Conduct Training was required of all employees of all Qwest affiliates and was developed and administered by QSC. The Corporate Compliance Code of Conduct Employees Booklet is provided on-line on Qwest's corporate-wide internal website. This annual compliance training included coverage on affiliate transactions, as well as the other requirements concerning appropriate employee behavior to ensure Section 272 compliance. Newly hired employees were required to complete this training within 10 business days of their starting date. After finishing the web-based training, employees were tested on each subject and were required to successfully answer the questions or were required to review materials again for incorrect responses. Upon successfully answering the questions, employees were presented with a certificate of completion and completion information on each employee was maintained within the Learning Management System (LMS), which is maintained by the Corporate Ethics & Compliance group.

  Noted that in 2005, the section 272 training was removed from the Code of Conduct training and added to the Telecom Act Training.

- Corporate Compliance Code of Conduct Employee booklet is required for all employees of QCII and all affiliates. It is developed annually and administered by QSC. All Qwest employees are required to annually certify their understanding of and compliance with company policies included in the Corporate Compliance Code of Conduct Employee booklet. This booklet contains language specific to the Qwest's section 272 obligations to ensure all employees understand the rules and regulations. Newly hired employees are required to complete this training within 10 business days of their starting date with Qwest. The Code of Conduct booklet is available internally at http://compliance/docs/CodeOfConduct.pdf, or externally at http://www.qwest.com/about/media/presskit/companyFact/.

- Telecom Act Training is required by all employees of QCII and affiliates. QSC developed and administered the Telecom Act training package related to the section 272 rules and distributed it to employees in September 2004. The training was required to be completed by December 31, 2004. In 2004, 99% of the employees completed the training. QSC represented that the approximately 1%

incomplete could be attributed primarily to routine employee status changes including, employees coming and going in military or other leave status, employees separating from the company, bridging of prior service, and other reasons. Those employees that eventually returned to work were required to complete the training upon return. Newly hired employees were required to complete this training within 10 business days of their starting date with any Qwest affiliate in 2004. The training emphasized section 272 transactions, nondiscrimination requirements and provided references for additional information. There was a "short" and a "regular" version of the Telecom Act training, but the employee obligations related to the section 272 rules were the same in the short and regular version. Based on job responsibilities, some employees received the regular version of the training because it included additional training on such subjects as Customer Proprietary Network Information (CPNI). After completing the training, employees were presented with test questions for each subject. In order to successfully complete the training, they must have been able to answer the questions successfully, or they were redirected to the material for a review and then had to answer the questions again until they were successful. When training was completed, employees were also required to acknowledge in the system that they had read and will follow the obligations. Subsequently, they were presented with a certificate that they could print for their records and the completion information was sent to the LMS. A similar Telecom Act training package has been developed and was released to all employees in September 2005. This package includes information related to the section 272 rules and emphasizes the section 272 transaction and nondiscrimination requirements and provides references for additional information.

- 272 Training for the Qwest BOC and QSC network department includes customized Section 272 Requirements training for network operations leaders and other employees. The training is ongoing and delivered by the Regulatory Compliance group to employees and groups of employees as they change companies or otherwise move into positions with a need to know, understand, and comply with section 272 OI&M rules.

- The Regulatory Accounting group provides on the job training for new employees in the Affiliate Transactions group and also conducts training sessions as needed to focus specifically on the compliance requirements related to section 272 and the Accounting Safeguards Order. Regulatory Accounting also holds staff meetings twice a month. Staff members include the affiliate transactions managers, who are the point of contact with the business units; pricing managers; and the lead manager of the billing and payments group.

- Regulatory Compliance Managers Training Sessions and Assistance – Regulatory Compliance managers from QC and QSC are available to Qwest business units to answer questions or concerns related to the section 272 rules. Throughout 2004 and 2005, Regulatory Compliance Managers have given training as needed to specific employees or groups. Training is targeted to the specific needs and questions of the group.

In addition to training programs, Management represented that the following information distribution resources were also in place during the Engagement Period:

- Corporate Compliance Advice Hotline is available to all employees for reporting all compliance issues and for reporting any suspected violations of section 272. The hotline number is 1-800-333-8938 and the email address is advice.line@qwest.com. This email address is able to receive requests from both internal and external Internet addresses. The Regulatory Compliance group is responsible for responding to the hotline and emailed requests. Any employee can call the hotline number anonymously for answers to corporate compliance questions or to report suspected violations. Employees are informed of this resource through a variety of means including Code of Conduct Training, Telecom Act Training, the Code of Conduct Booklet and the section 272 internal website.

- The email address, ask272@qwest.com, is available for employees to use to ask section 272-related questions. This email address is able to receive requests from both internal and external Internet addresses. When a question is submitted to the website, the employee will receive an auto response indicating that the employee should receive a response within five days. The emails are sent to persons within the Regulatory Finance group who research the answers and respond. Employees are informed of this resource through a variety of means including Telecom Act Training.

- The internal section 272 website which is maintained by the Regulatory Compliance group includes a link to the internal section 272 compliance page posted on Qwest's corporate-wide intranet website. The internal section 272 compliance page provides a site for all employees to access information about the section 272 rules including training materials, contact information, processes and forms.

- The Methods for Affiliate Transactions (MAT) manual includes Section 272 specific instructions for employees involved in affiliate transactions. The MAT manual is provided on-line on Qwest's internal website. All employees that are involved in affiliate billing are required to follow the MAT. As the MAT is updated, all employees on a distribution list receive an email notifying them that the on-line MAT has been updated.

- Regulatory Compliance Advice Requests – Questions may be submitted on-line to Regulatory Compliance Managers via Regulatory Compliance Advice Requests (RCAR). Employees are informed of this resource through a variety of means including the Telecom Act Training.

- Employee Bulletins/Emails – Risk Management sent a section 272 Obligations Reminder e-mail to all QCII employees in June 2004 and again in December 2005 to all QCII employees.

4. a. Obtained a listing of all written agreements for services and for interLATA and exchange access facilities provided under affiliate agreements and contracts between the Qwest BOC and the Section 272 Affiliates that were in effect during the Audit Test Period. This listing included 336 non-tariffed affiliate agreements and a listing of Universal Service Order Codes (USOCs) provided to the Section 272 Affiliates under tariff. Noted that 135 of the 336 non-tariffed affiliate agreements were still in effect at the end of the Engagement Period. Obtained termination dates for non-tariffed affiliate agreements that terminated during the Engagement Period. Management represented that no agreements between QC and QCC or QLDC were terminated prematurely. Management represented that during the Engagement Period, there were a few instances where service was provided between the Qwest BOC and a Section 272 Affiliate for a short period of time before a written agreement was in place. These instances are reported as late Internet postings in Procedure 5 below, and are listed in Attachments A-1 and A-2.

   b. Obtained a listing of 263 non-tariffed affiliate agreements, amendments and addenda that became effective during the Audit Test Period. Randomly selected 80 affiliate agreements and obtained copies of the selected agreements.

5. Using the sample of 80 affiliate agreements selected in procedure 4 above, viewed each Section 272 Affiliate's section of the Qwest Internet site, www.qwest.com, and compared the prices, terms and conditions of services and assets shown on this site to the copies obtained in Procedure 4 above. Noted that 19 of the 80 affiliate agreements tested terminated had been removed from the Qwest Internet site before the testing date of October 26, 2005. Management represented that these 19 affiliate agreements terminated during the Engagement Period and were removed from the Internet site one year after termination. Obtained the termination dates for the 19 agreements and noted that the terminations dates were over one year prior to the testing date of October 26, 2005. For 61 of the 80 affiliate agreements, noted no differences.

   On December 19, 2005, physically inspected the information made available for public inspection for the 61 active affiliate agreements at the principal place of business for the Qwest BOC, 1801 California, 6th Floor, Denver, Colorado, 80202. Compared the tested